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Cooperative Marketing:
Its Practical Problems

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THE COOPERATIVE IDEA has been attracting much attention of late. For the past 75 years, and especially the last 30 years, we have found farmers cooperating in the local assembling and marketing of grain, livestock, dairy products, potatoes, tobacco, fruit, pecans and walnuts, and numberless other products. They have cooperated in buying farm supplies, even to the extent of operating complete grocery and hardware stores. We have long had farmers' mutual fire and tornado insurance. Now we are seeing cooperative auto insurance, with life insurance in the offing. We have cooperative credit, cooperative power lines, and consumers' cooperatives.

Just now, cooperation is receiving much attention as a philosophy of life. The complete unionization of labor, the complete organization of farmers' cooperatives, the uniting of consumers (and that is all of us) into vast organizations to protect themselves in matters of quality, service, and price, with the government taking over all those activities which can be handled best under centralized control but cannot wisely be left to private or cooperative initiative — such is the picture of the future which numerous writers present. In fact, not a few leaders picture a cooperative democracy as the ultimate form of government.

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The Field of This Bulletin

Our object in this bulletin is not a discussion of these broader phases of cooperation; nor do we expect even to explore the whole field of cooperation in financial enterprise. We discuss cooperative marketing, and in that area only cooperative buying and selling of commodities through farmer owned organizations. Our emphasis, in fact, is on the internal problems of cooperative marketing associations. We feel, however, that we should approach our study in the realization that cooperative endeavor is widespread and far reaching, with cooperative marketing by farmers as one and only one of its important phases.

Volume of Business in Farmers' Marketing Organizations

To get a preliminary picture of what farmers in this country are doing in this field, one may examine the following table:

Estimated Membership and Business of Farmers' Marketing Organizations, 1933-34

Preliminary Report by Federal Farm Credit Administration

	Membership	Volume of Business
Cotton and cotton products	200,000	$ 100,000,000
Dairy products	757,000	380,000,000
Fruits and vegetables	185,000	182,000,000
Grain	600,000	285,000,000
Livestock	410,000	162,000,000
Poultry	73,000	48,000,000
Tobacco	46,600	5,500,000
Wool and mohair	63,800	13,700,000
Miscellaneous	128,600	36,800,000
	2,464,000	$1,212,000,000
Buying organizations	692,000	152,000,000
	3,156,000	$1,364,000,000

In Ohio, we have some 35 milk marketing organizations with a volume of business of some 15 to 20 millions of dollars; county and centralized livestock associations with about the same volume of business; farmers' elevators with grain and supply buying transactions amounting to a total of 25 to 30 millions; wool, fruit, vegetables, tobacco, and other organizations with volumes running to millions more.

Reasons for Forming These Organizations

Farmers formed these organizations, primarily and generally, to secure a better market in which to sell their products, buy supplies, or both. The improvement hoped for was most often a better price, but the fairer grading

* The figures are for the organizations reporting; complete records would probably increase the above by 30 to 50 per cent.

of grain or testing of milk was also a frequent objective. In most lines, too, the ordinary dealer was buying the farmer's product without grading it; he thus was paying no more for a good quality product than for a poor. Through their cooperative organizations, however, farmers are now selling tobacco, eggs, wool, and livestock on graded bases which furnish the farmer a motive for putting out a quality product.

Sometimes the motive for organizing arose from the belief that the farmer's own agencies would study his needs, and not only perform some services which were not being offered him, but also find more economical ways of doing them. The market news service of the Cincinnati greenhouse growers illustrates the one, the reduction of milk hauling costs the other. Most cooperatives, once started, soon set to work on both the aforementioned objectives.

One value of cooperation little emphasized by early organizers was the education of producers in market procedure and market demands. Through his cooperative the farmer has learned much about the steps in the marketing process, how the market operates, where wastes and losses occur and possibly how to reduce them, what grades or kinds the market wants and why, when to market, and the importance of planning his production to prepare for market peaks. To many a farmer this has been the greatest value of his cooperative.

Promoters have often pictured the great profits middlemen were making, and without doubt thousands of farmers have joined cooperatives in the hope of securing some of these profits. Sometimes the profits were found to be there; more often it was found that the middleman had expenses of which the farmer had not known — and when these unforeseen expenses had been met, there was little profit left, or mayhap even a loss.

Some Cooperatives Should Not Have Been Organized —

In this connection it must be recognized that the cooperative movement, just like any other social movement, has had its periods of ballyhoo; that dozens of cooperatives have been an outgrowth of enthusiasm rather than of study of the situation; that because of the success of some other cooperative, many a cooperative has been formed where success was hopeless. In one state some 300 cooperative creameries were established, though probably in four cases out of five, the respective communities did not have cows enough to furnish the necessary volume for economical operation. How many cooperatives have been formed even in Ohio, simply because some private dealer had an old plant he wanted to sell, will never be known. No social experiment involving thousands of communities can occur without being accompanied by things of this kind. They have cost farmers many a worry and thousands of dollars. We must remember the lessons such things teach — we must not forget that there are still people who are endeavoring to use the cooperative movement for selfish purposes. At the same time we can recognize also that cooperatives generally, and especially in Ohio, are beyond this introductory period, and in dozens of cases are on probably sounder basis today than the average private business of the same kind.

What Makes An Organization Cooperative?

No one has succeeded in wording a very helpful definition of "cooperation," especially a short one. For a legal definition for cooperative marketing we can go to either Federal or state law; we shall find them in substantial harmony.

In 1922 Congress passed the Capper-Volstead law providing certain types of protection for an association made up of "persons engaged in the production of agricultural products," which association may be

> Corporate or otherwise, with or without capital stock, and must
> Be operated for the mutual benefit of the members,
> Handle no more business for non-members than for members, and
> Allow only one vote per member, or limit dividends on the capital stock to not more than 8 per cent.

The Ohio law has substantially the same provisions except that it forbids dividends on stock in excess of 8 per cent, and makes definite requirements of the one-man-one-vote practice only in case of organizations without capital stock. Nearly every Ohio cooperative, however, limits each stockholder to one vote. The Ohio law further limits any one person's holding of common stock to one-twentieth of the stock outstanding. The phrase of the national law "operating for mutual benefit of its members" is carried into effect through paying dividends in proportion to patronage; the Ohio law uses the wording "shall be distributed . . . on the basis of patronage."

Why Conform to the Legal Definition of a Cooperative?

Those organizations which conform to the requirements secure certain protection and certain privileges under the law. For example:

1. They are protected to a degree from unfair attack under the Valentine and other anti-trust laws. A few farmers who are trying to organize to protect their marketing interests cannot now be thrown into jail for organizing, as has happened a few times in Ohio, nor is it any longer illegal for an association to have marketing contracts with each of several thousand producers.

2. The cooperatives have had a legal status as such under codes, grain exchange, and other regulations. When the code authorities (1934) tried under their rebate rules to prevent cooperatives from paying patronage dividends, an order from President Roosevelt forbade that interpretation of the rule. When the Chicago Board of Trade tried to rule the Farmers' National Grain Corporation out of trading privileges on the exchange floor, primarily because of its cooperative features, the Board of Trade was prevented from so doing.

3. In taxation, cooperatives by proving their conformity to the Capper-Volstead law can gain exemption from Federal income tax, which otherwise would take about one-seventh of their net income; likewise a flat tax of $10 takes the place of franchise and other state taxes.

4. A cooperative is eligible to borrow from the Federal Bank for Cooperatives on very favorable terms.

Cooperative and Private Corporations Contrasted —

The corporation has proved as valuable in farm organization as in other lines of business. As a business structure the cooperative corporation is not essentially different from the straight business corporation, but it does differ in aim, control, and patronage relationship. The contrasts can be briefly set up thus:

Straight Business Corporation	Cooperative Corporation
Aim — To make profits which will appear as dividends to the stockholders in proportion to their stock holdings. The bigger the dividends, the better.	*Aim* — To effect savings for their members and render them better services than they would otherwise have. Dividend on the stock limited.
Control — Money votes (one share, one vote) and is the controlling power.	*Control* — Men vote (one man, one vote). Sometimes, but rarely, commodity votes in part; i.e., the various areas served have representation on the board in proportion to the volume of grain, milk, etc., the association handles from that area.
Patronage — It is not essential, or generally material, that stockholders trade with their company.	*Patronage* — Members must give the cooperative their patronage or it will either soon go out of existence or fail to be a real cooperative.

But when should a cooperative be set up? Surely not simply because one of that kind has proved successful elsewhere. A cooperative should be set up with the same care as a similar private enterprise — probably even more care, because a hundred proprietors rather than one or two are to be kept satisfied. Is there a need for the proposed enterprise? What services will it perform? Will it be able to perform them with any more efficiency or economy than the prospective patrons already enjoy? What volume may be expected? What capital will be needed? Can it be raised? To what extent can prospective members be interested? What past experience have they in cooperative business?

Member's Attitude Toward His Association —

And when it is set up, what will be the attitude of its members toward it? Will they cooperate? Will they bring it their business? Will they be boosters for it in their respective neighborhoods? Will they listen with patience as their officers explain the unexpected problems which arise, the expenses which had not been anticipated, the need for more capital?

Or will they use their cooperative as a "club" to get better prices from the competitor — call up their own organization, find out its price, and then go shopping for a better price? Will the member who has put in $100 for a share of stock act on the theory that he is entitled to credit at the co-op office to the extent of $100 (which is virtually withdrawing his stock subscription)? No enterprise can hope that its members will continue to trade with it at continual financial loss; on the other hand, any member would seem to owe it to his fellow members to join with them in giving their joint enterprise a volume of business sufficient and for a period of time sufficient to give it a real opportunity to show what it can do. If not, why join at all?

A member frequently looks upon his cooperative as "just another dealer"; he speaks of it as "they" not "we" (especially if it has a bad year). What it would mean to the cooperative if all its members could get and keep the "we" attitude!

The Form of Organization

How shall the cooperative be set up? Whether it shall be set up as a capital stock organization or as a membership organization is determined largely by the amount of capital needed. A dairy cooperative which plans to be merely a bargaining association does not need much capital, nor does a livestock or a fruit association which sells the farmer's products and then after it has the returns from the sale settles with the producers. Such an association often requires from each member a membership fee; operating expenses are procured through annual dues, or better through a deduction per unit handled.

When a group of farmers plans to own and operate an elevator business, a packing plant, a flour mill, or other enterprise requiring buildings, machinery and inventory, much larger funds are needed. In such cases, a capital stock set up is more often used. Each member subscribes for one or more shares of capital stock. This type of organization offers considerable flexibility, as, if more capital is needed later, more shares of stock can be offered for subscription.

It is not, however, impossible for a membership organization to have a large investment in its enterprise. Many Minnesota creameries were financed on a membership fee, with a blanket note signed by all on which the bulk of the money needed was borrowed; this borrowed money was repaid through a deduction of say, 1 cent per pound of butterfat. Any blanket note plan of raising money is of very doubtful soundness, though it worked out almost uniformly well in this case. Another method much used by membership associations is the issuance of "certificates of indebtedness," which are promissory notes of the association usually for $5, $10, or $25 each. The member, in addition to paying a membership fee, subscribes for whatever amount of certificates of indebtedness he wishes.

In comparing the two methods of raising capital, one notes that certificates of indebtedness usually bear an interest rate and a definite due date; thus in case earnings are small or are needed in the business, certificates may cause an interest drain as long as outstanding, and may happen to fall due at a time quite inconvenient to a developing or harassed association. Capital stock, on the other hand, receives dividends only as declared by the board of directors, and "capital stock never becomes due." Even a preferred stock carrying a cumulative dividend does not create a debt which must be met; it merely requires payment of the accumulated dividends before dividends are paid on the common stock.

Do Not Fail to Incorporate —

Whatever the plans regarding membership or stock, incorporate. Without incorporation, a group of persons will be held at law to be partners, with each one liable for the debts resulting from group activities. Incorporation reduces one's liability to whatever remains unpaid (if anything) on his stock subscription or membership fee.

Further Points Regarding Organization —

Provide sufficient funds. Probably no one thing has wrecked more enterprises, private as well as cooperative, than the assumption that the capital needed to buy or build a plant will be all that is required. Working or operating capital is also needed. To buy and carry on hand a stock of goods; to improve and add to equipment; to make advances to patrons on butterfat, fruit, grain, livestock, potatoes, or what not, for which the association may not get returns for weeks or months; to carry thousands of dollars of accounts receivable — these in varying degrees should be carefully considered in advance, for often they require more capital than does the purchase of the plant.

Kinds of stock. In a stock company, the stock may be all of one kind — common, or there may be common stock and also preferred stock of one or more kinds. In farm cooperatives, the common stock carries the voting rights, and most companies have a limit of one vote per stockholder regardless of the number of shares held. The Ohio law forbids the issuance of the common stock (or of a membership certificate) to any person not a producer of the agricultural products to be sold through the cooperative. Preferred stock may be held by anyone, producer or not. Thus it can be used to secure funds from anyone who desires it as an investment.

The preferred stock has just what preferences are given to it in the stock certificate, the articles of incorporation, and by-laws. Usually it entitles the holder to a fixed but low rate dividend before any distribution of dividends to the common stock. This preferred dividend may be "cumulative" — that is, if not paid in one or more years, the accumulations for the entire period unpaid must be paid before any dividend to common stock. Sometimes, too, in case of sale of the business, the holders of preferred stock are entitled to a given value per share and no more, all the remaining net worth to be divided on a share basis among the holders of the common shares. Read the preferred stock certificate to learn just what rights you will have when you have bought it.

Preferred stock is often referred to as "guaranteed." By no means. Dividends on either preferred or common stock can legally be declared by a board of directors only out of surplus (arising normally from net profits). Even if there are profits, they often are needed as working capital and are not paid out in dividends, especially in the early years of the company.

Par value of shares. The earlier tendency was to issue stock in shares of $100 par value. In the period of farmer prosperity, 1900-1920, farm organizations of several types generally used the same figure. It is now coming to be recognized that volume of business is at least as important as capital stock in the financial life of a company, hence it is important to make it easy for farmers to become stockholders. The requirement that a cooperative do no more business with non-members than with members makes it imperative for many a company to get in some new members if it is to be entitled to recognition as a cooperative. But not so many farmers today are ready to lay down $100 for a share of stock. As a result, company after company is now reducing the par value of its shares, by issuing for each $100 share four $25, five $20, or even ten $10 shares. This places the cost of a share down to where anyone interested and eligible can become a shareholder.

Many companies let the applicant give a note for a large part of the purchase price, the dividends to be applied to extinction of the note.

Set-up of bargaining and agency associations. In the bargaining type of milk association, the membership fee is usually $1 to $5, and may be either a life membership fee or an annual fee. In Ohio the common plan is an entrance fee followed by a deduction of 1¢ or more per cwt. of milk handled. The livestock associations likewise have generally collected a small membership fee from each member, supported the association through a deduction for operating expense and for insurance, and then accumulated working capital, if any, through savings from this deduction.

Distribution of earnings. Our readers may regard the proper distribution of earnings as a problem for the board of directors to solve as it arises. General principles regarding it can, however, be provided in the original set-up, and much injustice has been done by failure to think the problem through; therefore, we propose it as a problem of original set-up.

The theory of the cooperative is to operate on as low a cost as is consistent with efficient service, this cost to include a fair return on capital, and the setting up of a proper reserve. This low cost of operation should result in net earnings. But a cooperative gains its privilege as a cooperative, its exemption from certain taxes, and its right to borrow on favorable terms from the Bank for Cooperatives*, by virtue of being a non-profit institution — that is, its profits are not for its owners as members or stockholders, but as *producers*. It makes this true by refunding these earnings or profits to its patrons on the basis of patronage given the company by the respective patrons.

The demands of fairness to patrons. A problem arises, however, when a company is, either through membership fee basis or capital stock basis, seriously under-capitalized. It is not sound practice for the company to pay out all its earnings and continue in debt or handicapped for working capital. So the directors hold in company surplus the earnings which otherwise would be distributed to the respective patrons. There are in Ohio today many farmer-owned companies with surpluses running $10,000 to $50,000 — in some cases several times the capital stock. Many a patron has given his company business yearly running into the thousands on which the company has piled up $10 to $100 a year of surplus. Yet should this member retire from the company or should he die, he or his heirs would get possibly the par value of his shares, but little if any of this surplus to which his business has contributed.

* The Louisville Bank for Cooperatives, a part of the Farm Credit Administration of this district, makes three types of loans, the rates indicated being those in effect Nov. 1, 1935:

1. The so-called "facility loans" secured by first mortgage on the plant and equipment of the borrower; the rate of interest is the same as charged on farm loans through a farm loan association, at present 4 per cent per year.
2. Merchandising or working capital loans, at present at 3 per cent per year.
3. Loans secured by mortgage on stored farm products, at present at 2 per cent per year.

Justice as well as the cooperative law condemns such a situation. Let net earnings over proper reserves and an interest dividend on the stock be distributed each year on a patronage basis. To all non-stockholders the dividend need not and should not be paid in cash, but set up to the respective patron's credit until it accumulates sufficiently to buy a share of stock, when it is issued to him. Even to stockholders, if the financial needs of the company so dictate, the credit can likewise be set up to purchase them added shares of stock, such practice to be continued for at least part of the dividend until the company is properly capitalized.

In a membership company the same principle can be followed, substituting certificates of indebtedness and membership for stock certificates. Such a practice protects both company and members.

Membership contracts. The importance of volume of business has been mentioned. The larger the volume of business, the less the cost of overhead per unit handled; many a company could handle double the volume of business at perhaps 25 per cent additional cost of operation. Often volume is just as important in bargaining power and market control; an association controlling 90 per cent of the milk going into a given market can bargain more effectively and protect not only its own members but all the milk producers of the area, far better than if it controlled 50 per cent of the milk.

Hence the Ohio act (Sec. 16) authorizes "marketing contracts requiring the members to sell" through the association. These contracts are enforcible at law and are occasionally so enforced; they have a legitimate place in protecting the association for a trial period and occasionally thereafter. Experience has shown, though, that no contract, however ironclad, can long hold members in line unless the association is performing a reasonably satisfactory service. Today the contract is thought of mainly as a clear cut statement of what the cooperative and its members are rightfully asking each from the other and uniform for all; actual enforcement at law is reserved for emergency and unusually refractory cases.

The Board of Directors

The whole body of members of shareholders of a cooperative association have the right to vote on adoption or amendment of the articles of incorporation or the by-laws of the association, on all questions of general policy brought before them, and in the election of directors. The by-laws may provide that the members elect the president and secretary, but generally the members elect the five, seven, or more directors, and then the directors elect the officers and the employes.

Unless the by-laws of the association provide otherwise, a board member's term of office is one year, and there is each year an election of an entire board. Many cooperatives — in this state most of them — regard it as unwise to run the chance of an entire change and the incoming of an entirely inexperienced board. A common usage is to provide a 3-year term for directors, the members electing one-third each year. Some authorities on cooperation favor a 2-year term, with half of the board retiring each year.

Powers of the Board —

In general, "all the capacity of a corporation shall be vested in and all its power and authority . . . shall be exercised by a board of directors, which shall manage and conduct the business of the corporation." So reads the Ohio code. This indicates the importance of care in selecting directors, for once in office they are in control; no stockholder can interfere, nor can the whole body of stockholders interfere, nor will a court interfere except on rather conclusive proof of fraud or a violation of law or the articles of incorporation.

In many things on which stockholders sometimes vote, like dividends to be declared, reserves to be set up, building funds to be accumulated, or a credit policy to be adopted, a vote of the stockholders is really advisory. The directors have far more complete information regarding the problems of the company, its financial situation, the costs of proposed changes than is possible in general to the membership. Many decisions, too, must be made under circumstances which forbid consulting the members — decisions which it might be dangerous or impossible to overturn later; hence when a board of directors has been elected and has assumed its duties, the board is in control of the affairs of the association and, in general, its acts are final.

The directors usually welcome and even seek the advice of the membership where possible. The board must recognize the importance of retaining the confidence of the members; on the other hand, the members must recognize that as a rule their knowledge of company affairs is general rather than specific, and that their advice to the board cannot safely be more specific than their knowledge.

In his relations with the board and board members, the ideal board member is one who tries to discover the problems of the company and find solutions for them, who states his views in board meetings and argues for them, and who votes his views until convinced to the contrary but who, once the board has decided, accepts the majority verdict whether or not it was his original view, and then in his talks with association members explains and defends the position of the board. "Divide as we may in our own native land, to the rest of the world we are one."

Director a Link Between Patrons and Management —

The good board member is a point of contact between the members on the one hand and the company on the other. Each member of the organization knows one or two board members to whom he can talk in a friendly and confidential way; he can state criticisms he has or hears, suggest new types of service, warn of dangers, pass on compliments. The board member, without repeating names and as he deems them worthy passes these suggestions on to the board or manager. On the other hand, each board member should be alert to keep his neighbors informed regarding progress of the company, its projects for improvement, and such of its problems as warrant general discussion.

One hears frequently: "We have too big a board. We should get more done with a board of three members." Maybe. But in a cooperative with hundreds or thousands of members to keep informed and satisfied, the larger board of seven or nine members has its merits.

In fact, organizations covering a wide territory find that even a large board of directors provides insufficient contact between members and company. Hence, they have in addition to a board of directors of seven or more members, an advisory council in which every local has a representative. In this case the councilman must be the principal contact man. He brings to the council meeting, as to the board members, the criticisms, misunderstandings, and suggestions of his neighbors, and carries back to his neighbors the information about the company and its program which he got at the meeting. However, the function of the council as such is advisory, as its name implies. It is doubtful if under the law it has any real power; the board is the controlling body.

The Manager —

The board selects a manager. Shall it then abdicate, and leave everything to this manager? Some boards do. Cooperatives, however, need directors who can and do direct, who are alert to changing conditions, who bring to the board meeting the criticisms and suggestions gotten from patrons, who determine general policies such as new lines or services to be offered, credit policy to be followed, distribution of earnings, extensive plant changes. Directors are needed who require regular reports from the manager — reports in sufficient detail that the board members may know what is going on and why.

This does not mean that the board or its members shall actually do the managing or shall interfere in the daily operations of the business. The manager is presumably a specialist in his field; while the board determines general policies, the execution falls on him and should be left to him. There must be the closest cooperation and harmony of board and manager, but the manager should always recognize a friendly but nevertheless complete responsibility to the board of directors for all his acts as manager.

The Manager's Compensation —

Neither the board of directors nor the members should forget that "the laborer is worthy of his hire." Company members and often even directors do not realize the numerous kinds of specialized knowledge, the background and experience necessary to good managership, nor the problems and worries which fall to the manager's lot. They see only the physical activities in evidence on their occasional visits to the office. How often has one heard members talk as though any good hired man could do the manager's work — they may not word it that way, but that is what their thought really is. One company in Ohio had a manager who had carried the company from a big deficit to a dividend basis, and who had made money for them nearly every year of the depression; but was let out on the score that he was getting more money than a former schoolmate of his could make farming!

As a matter of fact, few cooperative managers receive either wages or raises in wages, corresponding to what equal responsibility and success would bring in private business. A good manager is a real asset to any organization — generally the main motive power in everyday operations — and should be paid in proportion to the services he renders.

On What Basis Shall the Manager Be Paid? —

The farmers' elevators and the dairy organizations almost universally pay the manager a flat salary per month or per year; likewise the livestock commission companies. The county livestock associations, on the other hand, have usually allowed the manager a commission of so many cents per hundredweight, which might be the same for all kinds of livestock or might vary. The commission plan has some advantages for a beginning enterprise, in that this one of the major items of expense increases only as volume of business (and presumably income) increases; some boards, too, think "a manager will hustle harder if his own income depends on his efforts."

On the other hand, the commission plan gives the manager a constantly fluctuating salary, perhaps more than twice as much in one season as in another; it is fair, too, to recognize that most of the changes in volume are due to other causes than the efforts put forth by the manager.

Some companies in unusually good years share the unusual profits with the manager and maybe other employes through a bonus or a "Christmas present."

Everyday Operations of the Cooperative

Price Policy —

One of the first questions to be decided is that of price policy. The primary objective in establishing the cooperative is to secure a better market, and in seeming obedience to this thought, early cooperatives often "cut prices" on sales, or "overbid the market" on purchases. This has two bad results: (1) It likely starts a war — a war, maybe, with a competitor better financed than the association and with trade contacts already established; (2) profits of any amount are impossible in such a situation, and the member soon asks, "What do I get for belonging to the association? I might as well trade with my former dealer."

On the other hand, cooperatives now generally follow the Rochdale principle of maintaining price at or near the competitive level, endeavoring to attract trade by service, quality of product, and education of patrons. A competitive price far more likely results in sizable profits. This makes possible reasonable dividends on stock and patronage; the patron can now look at his dividend check, and say: "See what I get for having my own company and trading with it." This policy also results in far more friendly relations and even mutually advantageous cooperation with other dealers in the market.

Education of the Membership in Their Marketing Problems —

Farmers are no longer producing mainly for personal use; they are commercial producers, producing for a market. The more they know about the demands in that market — what products it wants in kind, grade, packaging; whether it is soft or hard wheat or a mixture; white or other oats; heavy or medium weight hogs; whether sacks, or bushels, or half bushels of the various fruits or vegetables — the better they can sell in that market, the better they can guide and adapt their production to prepare for selling, and the more profits they make. It is the business of the cooperative not only to help the farmer sell what he happens to have produced, but to help him produce what will sell to best advantage. A potato cooperative, finding that a car of one kind and grade sells to advantage. may persuade a community to combine on one type of early and one type of late potato. A poultry association conducts egg grading demonstrations; a fruit association may advise its members regarding varieties to plant, fertilizers to use, or sprays to protect the crop.

The average member at first expects the impossible from his association. He has little idea of the complexities of the market, and of the small place a local organization can play in it, especially in determining price. A cooperative owes it to itself as well as to its members to make clear to them the market procedure so far as it bears on the operations of the association, and just what parts in this procedure the association expects or endeavors to play; what problems it has to overcome, and the progress it is making in so doing. For example, a dairy sales organization must continually keep before its membership accurate and up-to-date information on the percentage and lesser value of the milk going into manufactured products; the average member does not see much beyond the bottle price.

A cooperative must help its members learn the market procedure and how to adapt themselves to it; the elevator association often has representatives of the market speak at its meetings; the livestock association organizes tours of producers to the market; the dairy association takes producers through a milk plant; and far more of this sort of thing should be done.

"The overhead is too heavy"; — maybe and maybe not. Here lies one function of good records at the annual meeting and the further importance of having them well explained and discussed. The patron knows there are power, tax, insurance, repair, and other bills; but some way he just overlooks these things, mostly, and assumes that expense means almost entirely wages of a few men. For example, the stockholders of one elevator company, on hearing that the expenses incident to the yearly sales of $125,500 were $14,400, might easily have thought that $14,400 of expense meant too much paid for wages. The report showed $1100 for power, $1550 for depreciation, $830 of reserve for bad accounts, $800 of taxes, $600 of insurance, $900 of truck expense, and several other sizable items, leaving less than $7000 for all wages of management and of operation of plant, grinding, and truck operations. A real service to both members and organization has been performed when the expense items have been explained and discussed.

In fact, had this been properly done in advance, some cooperatives would have saved a considerable sum of money by failing to organize. The promoters of a new cooperative are really taking upon themselves a big responsibility. They are urging farmers to put thousands of dollars of capital into a new business venture, and to trust to this new enterprise the handling and sale of hundreds of thousands of dollars of produce or supplies. In fairness to the farmers and in protection of their own reputations the promoters should court the fullest inquiry into probable volume, expenses of operation, possible legal complications, attitude of the locality toward cooperation, and any other question affecting the future of the enterprise. It is a continually recurring puzzle to workers in the field of cooperation that they are so often accused of opposition to cooperation, on no other ground than that they try to help the men who are taking the risk to see as much of the whole picture as possible beforehand, and go into the venture with open eyes.

Keeping up a Live Membership. —

Farmer organizations which date back to 1920 or earlier are likely by this time, especially if on a capital stock basis, to have several inactive members, and possibly a declining active membership. Sometimes the banker, the merchant, or other villager took shares of stock to be a good fellow; some farmers have retired; some have died, leaving the stock to a son or daughter not in a position to patronize the cooperative; some have pledged the stock as security on a car or other purchase, and it is now owned by a non-farmer.

The Transfer of Stock. —

Many companies anticipated some of these situations, and provided in their by-laws against transfer of the stock to any but the company, or to any non-producer. The courts have held that unless proof is available to show that the new holder has knowledge of this by-law, he is an innocent purchaser for value, and the by-law has no significance. The Ohio cooperative law provides that the common stock certificate shall bear on its face a clause forbidding transfer to a non-producer. An increasing number of companies, too, are providing that the Board shall have the right to call in and retire the stock of any person who has ceased to trade with the company for a definite period — say two years.

We have already referred to the problem of getting in new members, especially when the share has a par value of $100 or even $50. The tendency today is toward reduction of par value to $25 or even $10 per share. An increasing number of cooperatives set up patronage dividends to all farmer patrons (not to dealers, wholesalers, brokers); the dividend on the non-stockholder's patronage is accumulated to his credit until it is sufficient to pay for a share of stock or a membership, and thus he is brought into membership.

The Interest of the Patron in the Surplus —

Sometimes a problem arises through the fact that a large surplus has been built up; the stock may today have a book value two to five times its original value. Present stockholders hesitate to let new ones in on a par basis. Two things can be said: First, while the early stockholders carried the risks and may claim title to the accumulated surplus on that basis — they do have legal title — they should recognize that this surplus was built in most cases not on stockholder patronage alone, but in part on the trade of these prospective new members, so it is not unfair to let them share in it. Second, if the surplus is considerable, it should be possible to arrive at figures fair to former stockholders and yet attractive to new stockholders. The following illustration may make this point clear.

Take the case of one company whose surplus is slightly more than its capital stock, and its stock has a book value of slightly above $200 per share. This company at present sells a share of stock to a new member at $125, but several good patrons either cannot or will not put that much money into it. More than half the business is with non-stockholders, and if the company wishes to secure the advantage of being fully cooperative, more of these patrons must be brought in. If it is decided to reduce the value of the shares, shall present stockholders receive four $25 shares for each $100 share, or shall they, because the shares have a book value of $200, receive eight $25 shares? In view of the fact that the surplus was accumulated partly from the business of these non-stockholders, why not give, say, six $25 shares for each $100 share? This would give half the surplus as a dividend to former stockholders, and keep half of it in the company as a surplus to the stock of old as well as new stockholders.

Why not also have a committee of the board actively at work with the manager in getting into the company some of the good patrons still on the outside?

Records —

Good business records are a necessity to any business enterprise. Their function in dealings with patrons; their value in analysis of income and expense, and in comparing one season or year with another; and in general, as a guide in decision of policy or operation, we do not discuss, for these values of good records are common to private and cooperative business alike. To the cooperative, however, with the necessity of keeping satisfied a hundred or a thousand or more members, good records furnish the best and generally the only definite answer to question or criticism. Times without number has the writer seen the whole attitude of a dissatisfied group of stockholders changed by the presentation of a few figures from the association's business report, or a brief analysis of the income and expense account showing where most of the expense money went.

"Volumitis" —

We have emphasized in numerous places in this bulletin the desirability of a large volume of business to any business enterprise. The anxiety for business, however, may be carried too far — as for example, when managers pay for produce a price beyond what they can hope to get in selling; when they sell goods at prices leaving almost no margin to cover costs of operation and plant depreciation; when they sell to those unlikely to pay; when they truck goods for miles at no charge direct or included in price. Of course, any one of these things may happen occasionally in any manager's experience, and quite justifiably. When they happen often or as a policy, the manager may well ask himself whether he is succumbing to the disease "volumitis." Dozens of managers, for example, were so fearful in recent years that someone else would get some of the business they wanted that they handled poor quality oats on a margin of a half cent, and wheat on about one cent.

One objection to the commission plan of paying a manager is that it may encourage this very fault.

With few exceptions, cooperatives start off with too little capital; they have usually underestimated their needs, and worse yet, have frequently failed to raise the amount estimated. Thus they start out with a load of debt. If, as happened to thousands of companies, private and cooperative, in 1920-1, there are losses early in the company's history, the situation is one of deficit as well as debt. In such a case, all earnings for a time must be retained by the company and applied to extinction of deficit and reduction of debt. As pointed out below, until the deficit is extinguished no dividends can legally be declared, and all net earnings must be applied to the deficit. But frequently assets have been very seriously depleted, and the extinction of deficit would take years; dividends, too, would have to be deferred for the same number of years or more. Many companies in such a position have recognized the situation and have reduced the capitalization.

For instance, a company with four hundred $100 shares outstanding ($40,000 outstanding stock) finds its net worth $24,000, which means a deficit of $16,000. Their net earnings over interest are averaging about $2000 per year, and it would require 7 or 8 years to wipe out the deficit. If now they recognize what is the real fact, that regardless of what is written on the stock certificate as par value, the worth of each of the 400 shares is one-four-hundredth of the net worth of the company, no more and no less, they may vote to change the par value of their shares to $50. This changes their net worth of $24,000 at once to $20,000 capital stock and $4000 surplus.

This looks better in the statement they send to anyone from whom they buy, and also means that the board of directors may declare dividends whenever they feel that the financial position of the company warrants it.

Where Shall the Cooperative Borrow?

As in case of private borrowers, the place of first appeal was the bank. The bank would loan a limited amount on the corporation note; for larger amounts it usually asked the directors to sign as individuals as well as for the company. This is an unsound practice; no group of stockholders has any right to expect the directors to carry the risk of the company debt. In many cases, however, this loan of his credit by a director worked out happily; the company was saved from bankruptcy and ultimately paid out, with no cost to the directors except considerable worry at times. In other cases, the directors found themselves with a plant on their hands and its debts to pay. Certainly, if a director is to loan his credit to his company, far the fairer and safer way is for each director to raise his share of the money and loan it to the company; in this way he takes no risk for some other director's delinquency. Often the stockholders have recognized the unfairness of asking the directors to assume the credit load, and have protected the bank by a blanket note signed by 50 to 150 of the stockholders.

More recently, the Federal Banks for Cooperatives will lend reasonable amounts to cooperatives at rates and on terms more favorable than a bank can generally afford.

Dividend Policy —

What relation shall dividend policy have to the debt situation? First, the law forbids the declaring of any dividend when there is a deficit, or when the payment of the dividend would create a deficit.

Second, even if there is a surplus but the company is heavily in debt, the depletion of working capital or the borrowing of further funds to pay dividends is usually unwise. If a company has — say — 300 shares outstanding, a dividend of $5 per share costs the company $1500 and in case of a company heavily in debt, probably few stockholders need $5 as badly as the company needs $1500.

Third, "No, sir. Not a penny of dividend until all our debts are paid." This may easily be too conservative. When a company has paid its debts down to where its position is sound, and where a bad year would not threaten its permanency, the payment of a small dividend has repeatedly been found to beget confidence and good will to a degree far outweighing the small added interest cost.

Fourth, a steadily increasing percentage of cooperatives are paying patronage dividends. It is not only that governmental agencies are constantly putting more emphasis on the payment of patronage dividends even to farmer non-members. It is recognized that volume of business is important. It is the universal testimony of managers that patronage dividends have resulted in bringing in business.

Accounts Receivable —

"If we could collect what customers owe us, we could pay every debt we owe." This frequently heard remark may or may not refer to a serious problem. The cooperative must, in general, do business as its competitors do. In some lines of business, this calls for sales on credit. Here as elsewhere, localities differ and the attitudes of boards of directors differ; more important still, managers differ — differ in attitude, differ in ability to hold to a policy, differ in ability to help patrons to see the company's viewpoint. Hence, of two companies doing a $150,000 sales business one may have $4000 on the books in relatively active accounts, and the other may have $15,000 on the books of which a third is one to three years old. The remedy is prevention, and managers who have been in business the last five years have generally learned to select their risks, to have a definite understanding as to how and when the customer expects to pay, and to follow up the case to see that he does.

The growth of chattel mortgage lending in the rural community and the emergency loans by the Federal government on the basis of mortgages on crops, have added to the difficulties of the credit situation. This is just another of the places where the manager must be alert.

Discount for Cash —

One device which the trade, both private and cooperative, is using is the discount for cash. Seemingly this is entitled to more attention than it has received. When one figures bookkeeping costs, loss of the use of the money for 30 days to 2 or 3 years, time, and postage on repeated statements, and the losses on incollectible accounts, he realizes that the avoidance of all this is of real value. Many companies allow 2 or 3 per cent off for cash, or more often have two sets of prices, the cash price being approximately 2 or 3 per cent below the charge price.

Bargaining and Agency Association Problems —

These associations do not generally take title to the produce; the association, either as agent sells the produce for the farmer, or merely makes the agreement under which the farmer sells. This means that the farmer himself carries certain marketing risks, which he did not have when he sold to a dealer outright. Livestock associations have usually protected their shippers from losses through death or injury of stock in transit by collecting a fee of possibly 5 cents per cwt. on all stock shipped; out of this insurance fund such losses are cared for, the shipper perhaps never learning of the injuries. Likewise, the milk associations often protect their farmers from loss through a dealer's going into bankruptcy owing them for milk, either by requiring in advance a bond from the dealer, or by collecting a small fee per cwt. on all milk handled, thus creating a fund out of which such losses could be cared for.

Difficulties and Advantages of Cooperative Marketing

We close our discussion of cooperative marketing with a brief summary of the principal difficulties and advantages in cooperative marketing by farmers. Most of these points have been discussed more fully earlier in the bulletin.

Difficulties in Cooperative Marketing —

1. Insufficient capital. The amount needed is generally underestimated, and often even the estimated need is not met. Lack of sufficient capital handicaps operations, creates interest expense, and often delays dividends until dissatisfaction arises.

2. Lack of understanding of cooperative principles. The organization of many cooperatives is the result of a preliminary promotion meeting, a stock selling campaign, and an organization meeting. This offers little opportunity for training the members in cooperative principles and problems, members' responsibilities, or attitude toward non-member patrons. The new cooperative is to the member and the community just another dealer.

3. Closely related to the preceding is the fact that members too often expect the impossible from their association. Managers are all too often expected to take a member's produce at a grade or two above its real quality. Milk association members may expect to get for all their milk a price based on the bottle price, though perhaps not more than half the milk goes into bottles. And how many members seem to feel that their cooperative should "operate at cost" and still pay nice dividends. The member may not word his demands in this way, but nevertheless this is the attitude.

4. Poor management. When several hundred cooperatives are started in some 3- to 5-year period, there is no place to go to find several hundred good managers. The choice often lies between some good farmer who has little experience in marketing and, on the other hand, an "old line operator"

who knows markets, but does not know cooperation — possibly is not in sympathy with it. Good managers have worked cooperatives out of seemingly impossible situations; poor managers have wrecked companies which under even fair management should have succeeded.

5. Opposition of outside interests. The people who have been the farmers' middlemen naturally dislike to see the farmers do the business themselves. While the cooperatives have had no better friends than some of these middlemen, many have resorted to misrepresentation of the cooperatives' operations, unfair criticisms, bribery of employes, special prices to leading patrons and even directors, general price cutting — have threatened and have spent money to "put the co-ops out of business."

Advantages of Cooperative Marketing —

1. The farmer can have the business run in his own interest. The cooperative can offer new services he wishes; it can work out more economical ways of performing services (for example, the improvement and economy of milk hauling when taken under management of cooperatives); it can place emphasis on quality of product or service sold to the farmer; it can afford to emphasize a long-time program rather than immediate profits alone; it works to serve and build up its community.

2. The cooperative can and generally does endeavor to train its members in what the market wants and when it wants it, and how to work with the organization in preparing the product to meet the wishes of consumers. The farmer learns, too, through his cooperative the methods and problems of the market and what it costs to market produce and why — with the results that sometimes he can avoid some of the costs and wastes, and in any case he is better satisfied and more contented through knowing the reasons for the situation.

3. Savings made. Cooperatives of the bargaining type generally get better prices, better terms, fairer tests, than the members were receiving before, so make savings which come directly to the members. Cooperatives which buy and carry in stock either farm produce or supplies for sale later, usually give farmers at least as good prices on the average as competitors — often the whole area is, because of the existence of the farmers' company, on a price basis more favorable to farmers. Normally, too, the cooperative makes some profits which at least pay a fair interest on the capital stock, and rather generally some patronage dividend which makes final price still better.

4. One value of a cooperative generally overlooked by its members is its advocacy of farmers' rights in legislative halls and elsewhere. The efforts of national organizations to secure tariffs protecting farm products, regulation of railroad rates, various plans for maintenance of farm prices, etc., are well known. Efforts of state and local cooperatives to secure trucking regulations fair to farmers and their organizations, proper market supervision, suitable board of health regulations, reduction of railway rates and discriminations, are not so well known but are no less important. Terminal grain men concede great credit to cooperative elevators for aid in overcoming numerous abuses in terminal trading of a decade or two ago.

Do Cooperatives Succeed? —

Cooperatives sometimes fail for the same reasons which destroy private enterprises — lack of capital, poor location, powerful competition, and, above all else, poor management. One frequently hears it stated without very much in real figures as a basis: "Statistics show that half the cooperatives fail," forgetting that fully three-fourths of private businesses end in failures. What statistics there are available — admittedly incomplete both as to private and cooperative enterprises — show that cooperatives are somewhat less likely to fail than similar private enterprises.

Attitude of the Government —

Lawmakers have recognized the handicaps under which the farmer as an individual labors in the marketing of his produce. Hence Congress and the legislature of nearly every state have given special recognition to cooperation in marketing. With some variation, mostly minor, these laws provide authority for organization and for all needful activities, protection from unfair attack under anti-trust laws, the right to combine efforts with other cooperatives, authority for marketing contracts with growers, and freedom from certain franchise and income taxes. Courts have very generally supported this legislation. Thus cooperative marketing clearly has the support of public opinion as expressed through our governmental agencies.

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